

VZCZCXRO1724

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DE RUEHBS #0151/01 0341324

ZNR UUUUU ZZH

R 031324Z FEB 09

FM USEU BRUSSELS

TO RUEHC/SECSTATE WASHDC

INFO RUEHZN/ENVIRONMENT SCIENCE AND TECHNOLOGY COLLECTIVE

RUCNMEU/EU INTEREST COLLECTIVE

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UNCLAS SECTION 01 OF 02 BRUSSELS 000151

SENSITIVE

SIPDIS

E.O. 12958: N/A

TAGS: [ECON](#) [EPET](#) [EUN](#)

SUBJECT: DAS BRYZA ENCOURAGES EU ENERGY INVESTMENTS AND COMPETITION

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¶1. (SBU) Summary and Introduction: EUR Deputy Assistant Secretary Matthew Bryza met separately with Steven Everts, Advisor to High Representative Javier Solana; Heinz Hilbrecht, EU Commission Director for Security of Supply and Energy Markets; and Jean-Paul Decaestecker, EU Council Head of Unit for Energy Policy in Brussels on January 30. Discussions focused on:

- promoting market competition,
- accessing Caspian gas through the Southern Corridor,
- improving relations with Ukraine, and
- enhancing cooperation on renewables.

Everts mentioned that in March, EU leaders will consider in a 3.5 billion euro investment package on a series of energy infrastructure projects, including gas and electricity interconnectors and carbon capture and storage pilots.

Hilbrecht said that the European Investment Bank would be prepared to finance the Nabucco project if it secures 8 bcm/a for phase I. End summary.

INTERCONNECTIONS AND MARKET COMPETITION

¶2. (SBU) In his meeting with Everts, DAS Bryza stressed the need for more competition in the gas market as well concern over Gazprom's 50 percent stake in the Baumgarten gas trading hub. Bryza emphasized the need for investment in infrastructure, particularly LNG terminals on the Black and North seas and gas and electricity interconnectors in/to central and eastern member states, whose vulnerability to Russia was exposed during the recent crisis. Everts acknowledged that significant steps need to be taken to develop a real internal gas market. He said the difficulties lie with the larger member states, such as Germany, the UK, the Netherlands and France, who place their own energy interests above the community's. He did note that Chancellor Merkel wrote to Commission President Barroso and Czech Prime Minister Topolanek on January 29 "urging" more interconnections, development of a market structure and diversification - citing Nabucco, Nord Stream and South Stream. Everts added that the Commission had just submitted a series of energy investment proposals under the EU's Recovery Package, to be taken up by the Council in March. He said significant sums were made available for electricity and gas interconnections in the Baltic and Mediterranean states, but less for central and eastern Europe. Decaestecker said the while the EU supports gas inter-connections, it might not support the NETS project to integrate operators in central Europe and the Balkans, as it is primarily supported by one

company, Hungary's MOL. Bryza noted that even incremental investments in central Europe would enhance competition.

TURKEY AND NABUCCO

¶3. (SBU) Fresh from his participation at the January 26-27 Budapest Nabucco Summit, DAS Bryza said the key to progress on the Southern Corridor is a transit agreement between Turkey and Azerbaijan. Azerbaijan seeks a &fair market price8 from Turkey for gas from the Shah Deniz (SD) II field, the primary source for phase I of Nabucco. Turkey seeks to maintain the well-below market structure it pays for Azeri gas from the SD I field, whereas Azerbaijan seeks an increased tariff for these supplies as well. Bryza opined that Turkey would maintain its position at least until the upcoming municipal elections scheduled for March 25. Hilbrecht said the problem is Turkey, which needs cheap gas to maintain its high growth rates. Turkey insists on 8 billion cubic meters per annum (bcm/a) from SD II but that would not leave enough gas for Nabucco. Bryza agreed this is too much; he said that Azerbaijan wants to retain sufficient volumes for direct access to the EU market, either through Nabucco or TGI. Hilbrecht said RWE and OMV have proposed a cost-based transmission regime with market guarantees in event of a crisis, but Hilbrecht is not convinced Turkey will accept the offer. Bryza said Turkey needs to think strategically, and that it may take a "political decision" between Prime Minister Erdogan and President Aliyev to wrap up an agreement.

¶4. (SBU) Another problem has been Turkey's insistence on

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linking the opening of negotiations on the Energy Chapter on EU accession with an intergovernmental agreement on Nabucco. Everts said that EU High Commissioner Solana, Commission President Barroso, and Enlargement Commissioner Rehn were "sympathetic" to this issue, but warned Turkey about painting them into a corner on the Energy Chapter. He said Cyprus remains obstinate on Turkey's accession, as well as EU-NATO relations, which he described as "its sole foreign policy objective." Everts added that France and the Netherlands also oppose the opening of the Energy Chapter, but they may be more flexible, particularly France, if Gaz de France joins the Nabucco consortium, which he said, Erdogan opposes.

¶5. (SBU) Both Everts and Hilbrecht said that financing would not be a problem if a transit agreement were reached. Everts reported that 250 million euros of "seed capital" has been set aside for Nabucco in the Recovery Package. (Note: 100 million euros were allocated for TGI. End note.) Hilbrecht said the EIB was prepared to finance Nabucco if deemed "viable," which would mean a supply agreement of at least eight bcm/a for phase one.

¶6. (SBU) Hilbrecht was also optimistic about securing Turkmen gas for Nabucco. Yashygeldy Kakaev, the head of Turkmengas Company told Hilbrecht that if there is an agreement to form the Caspian Development Corporation (CDC), Turkmenistan will make sufficient supplies available. Kakaev asked if Gazprom would be permitted to join the CDC; Hilbrecht said yes, as long as Gazprom was willing to behave like a market competitor. He also invited Kakaev to join the CDC steering committee.

UKRAINE

¶7. (SBU) Hilbrecht said that after gas flows had resumed in mid-January, Gazprom's Deputy Chairman Alexander Medvedev told EU officials that Ukraine's full transmission capacity needs to be maintained. Hilbrecht said that in reality, Gazprom seeks to circumvent Ukraine, and it cut off gas supplies in January as a justification for doing so. He said there is now a proposal to increase South Stream's capacity from 30 bcm to 46 bcm. This combined with Nord Stream's 55

bcm would divert much of 120 or so bcm currently transiting Ukraine to Europe. Thus, South Stream would no longer be in competition with Nabucco for Caspian gas but instead would be built to transmit Russian supplies and "squeeze Ukraine."

¶8. (SBU) DAS Bryza stressed the need to remain engaged with Ukraine and suggested a U.S.-EU-Ukraine working group to promote transparency and rehabilitate Ukraine's infrastructure, as referenced in the 2008 U.S.-EU Summit declaration. Decaestecker welcomed the proposal and said the Council Secretariat had made a similar proposal to Russia to promote transparency in Ukraine. Hilbrecht was less committal. He said a proposal to form a consortium of EU gas companies, Gazprom and Naftogaz to manage the flows had been put forth and received the approval of Energy Commissioner Piebalgs. However, European gas companies are apprehensive about investing the approximately 2.5 billion dollars needed to rehabilitate Ukraine's infrastructure.

RENEWABLES

¶9. (SBU) DAS Bryza proposed the U.S. and EU intensify cooperation on renewables and alternative sources of energy, as set forth in recent Summit declarations. He said while we must address the immediate need to promote interconnectivity and competition, we cannot lose sight of the strategic need to develop and deploy renewables. Decaestecker was keen on this idea and suggested we explore options in advance of this year's summit.

Murray

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